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Essential reading for the healthcare business

Wealth of nations

Hamid Yunis, partner at law firm McDermott Will & Emery analyses sovereign wealth fund investment in the global healthcare industry

Sovereign Wealth Funds (SWFs) are state-owned entities that are used as an investment vehicle by a state, and where the original investment funds are usually derived from state generated sources. SWFs in turn make investments into a variety of real and financial assets such as stocks, bonds, real estate, commodities, private equity and other trading arrangements. They invest both in their domestic markets and also increasingly on a global basis and are an important and growing funding and investment source alongside traditional investors.

SWF – aims and objectives

It's important to understand that SWFs have additional aims and objectives, and different characteristics, when compared with other investors. These manifest themselves in the way SWFs formulate and adopt their risk policies (including appetites and tolerances), the manner of their investment, their liquidity requirements, the length of their investment timelines and how they organise other priorities.

Occasionally, these priorities can include environmental, social and corporate governance aims. In particular, an SWF may look at the societal benefits of an investment and not just the obvious economic or financial benefits. An SWF can play an important role in the corporate governance of entities/companies that they invest into, this includes the exercise of shareholder rights and pushing for robust corporate social responsibility policies.

This stance can have a persuasive effect on the profile of such entities/companies and their attractiveness to other investors. SWFs, because of their size, resources and market profile and also their different investment aims and objectives, can be a force for good and change.

Santiago principles

A good starting point when discussing the investment approach taken by SWFs is the 24 generally accepted principles and practices voluntarily endorsed and adopted by SWF members of the International Forum of Sovereign Wealth Fund (IFSWF) in 2008. These principles have developed over the years but the Santiago Principles, as adopted by members of the IFSWF, continue to promote transparency, good governance, accountability and prudent investment.

The principles stipulate that the legal framework for an SWF should be sound and support its operations, with well-defined policy purposes that are publicly disclosed. Where activities have significant direct domestic and macroeconomic implications, activities should be coordinated with the relevant fiscal and monetary authorities and reported to governing bodies on a regular and timely basis. The principles also indicate that annual audits should be conducted in accordance with recognised international or national auditing standards, and, wherever there are third parties involved in the operational management, these activities should be conducted in compliance with best practice and based on sound financial and economic principles.

As a minimum, professional and ethical standards should be applied and clearly defined and known to all involved

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in the SWF's management and business. Also, all activities should be in compliance with all applicable regulatory and disclosure requirements of the countries and jurisdictions in which the SWFs operate.

Additionally, there should be public transparency to demonstrate the economic and financial orientation of the SWF and to contribute to stability in the international financial markets. Investment policies should be clear and consistent with defined objectives, and take into account risk tolerance, including leverage, selection of target, etc.

The Santiago Principles also assert there should be no advantage gained by using privileged, confidential information or inappropriate influence applied in competing with private or third-party entities.

Lastly, any investment should view the SWF's shareholder ownership rights as a fundamental element of their equity investment. Any exercise of such ownership rights should be done in a manner that is consistent with the SWF's investment policy and with the purpose of protecting the financial value of its investment.

The full extent of the Santiago Principles and their adoption by an SWF, or by its specific fund vehicle or investment entity, are a good indication as to how an SWF will approach a particular investment and should be fully understood by a potential counterparty when approaching or dealing with an SWF.

Investment in healthcare

The rapid pace of change in the global healthcare industry has created many opportunities for SWFs to invest. Most of the largest SWFs see the healthcare sector as an attractive, sustainable and resilient market. Developments in technology and innovation in particular have created opportunities for SWF investment.

SWFs have recently invested across a broad spectrum of the healthcare industry, including healthcare services and facilities such as hospitals (including mental health and high-dependency units) nursing care, ambulatory care services, teaching or university hospitals and healthcare professionals. ▶

Another attractive area for SWFs to invest are medical devices, equipment and hospital supplies manufacturers, including surgical instruments and supplies, dental and ophthalmic equipment, cancer care and radiotherapy equipment, as well as digital, remote, telehealth, and fertility equipment.

SWFs increasingly look towards the medical insurance market and medical services and managed care, including health maintenance organisations, pharmacies, and similar providers or services.

Finally, the pharmaceuticals industry and its related segments is also ripe with investment opportunities for SWFs, including research and development, drug development (particularly at the later stages), over-the-counter drugs, biotechnology, biopharmaceutical drugs, generic drugs, vitamins and supplements, and opticians stores.

The increase in the use of technology, and the swift pace of innovation in the global healthcare industry is very attractive to SWFs. As the global pandemic has changed behaviours, working and travel patterns are likely to evolve further, and the opportunity to utilise remote, internet-based technology has created new and potentially vast opportunities. In particular, the digital, remote and telehealth sectors present opportunities for rapid growth and investment and innovative partnerships for growth. SWFs can use their investing ability to invest globally in opportunities for technology transfer, and the creation of new and creative business models.

For example, there has been a trend towards innovative capital structures to support research by, and the commercialisation of, companies owned by universities or other educational institutions.

A typical structure would involve the setup of a commercial entity, where both the university and the investor take an equity stake and may also have other roles and responsibilities. An SWF may provide investment and financing to support research originating from the university, in return for a certain percentage of the equity in the vehicle. The ability to reengineer the investment or product back into an SWF's domestic market, and the synergies between the university and the educational and research establishment 'back home' can also be persuasive factors.

There are many examples around the world of SWFs involved in healthcare investment and related transactions, including in Egypt, Russia, Turkey, Qatar, the UAE, Saudi Arabia, Singapore, Malaysia, Canada, Nigeria and Norway.

A few recent transactions, direct and indirect, include: PIF (Saudi Arabia) and GIC's (Singapore) investments into Churchill Capital Corporation III; Mubadala's (Abu Dhabi) investment into Evotech; Temasek's (Singapore) investments into BioNTech and separately Shanghai Kinetic Medical. We have also seen PIF's (Saudi Arabia) investment into Babylon Health, Alaska Permanent Fund's investment into Denali Therapeutics and New Zealand Superannuation Fund's investment into Asia Pacific Healthcare.

The extent of direct and indirect investments by SWFs in healthcare and life sciences companies has increased substantially over the past few years. This includes sights across the spectrum of biotechnology, pharmaceuticals, healthcare provision and operation and through technology and innovation, and medical devices/equipment.

Collaboration and/or co-investment

Unrealistic valuations and asking prices driven by very competitive private equity demand and stock market/IPO volatility have all provided challenges for SWFs. As long-term investors looking for value, SWFs have therefore increasingly invested alongside a range of different investment partners including private equity funds.

Notwithstanding the trend towards co-investing, challenges for an SWF's investment activity still exist. These include the limitations of the conventional limited partner/general partner fund structures, fee structures generally and fund life cycles.

If it is felt that the basic private equity model does not necessarily create an alignment of interests, or maximise the preferred timeline benefits for an SWF investor, there are possibly other, more favoured structures, such as deal-by-deal co-investment and ongoing evergreen funds. Co-investment between an SWF and a private equity fund may require an adapted structure for both parties to fulfill their aims and objectives.

National and political concerns

An important point to bear in mind, and particularly relevant where SWFs are investing outside their domestic market, is the restriction around foreign direct investment (FDI). Investors, like SWFs, that acquire assets outside their domestic markets and are directly or indirectly linked to foreign governments, have to balance their investment profile with the underlying political or economic considerations. The Santiago Principles referred to above require a basic understanding that an SWF will not interfere in the political affairs of a country.

Countries that apply FDI restrictions, to a greater or lesser extent, include most of the EU, the UK, Australia, Canada, China, India, Japan, and the US. The subject of FDI requires a more detailed analysis as it concerns SWFs as investors, but this remains a very important consideration in the choice of an investment.

FDI restrictions move beyond the concept of national security, as this is sometimes considered to be too broad to provide guidance to regulators and participants, for its actual implementation in practice. There is also debate surrounding FDI 'acceptability thresholds' in certain jurisdictions that help to determine if FDI in a particular sector is acceptable. This threshold could take into account the landscape in which a business operates, the type of foreign investor, the local political environment and the influence of other parties.

Opportunities

SWFs are keen, active and important investors in the global healthcare industry. Their aims and objectives are generally conducive to co-investing with other investors, and the economic and financial benefits of their involvement, both in terms of their ability to invest substantial sums and their wider aims and objectives, makes them an attractive partner. They are likely to continue to see the industry as a good opportunity for growth and in need of active investment, which should also help in the ongoing drive for better governance and representation, and perhaps create more impetus for regulatory intervention in cross-border activity.